

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended March 31, 2010



JOHN CHIANG
California State Controller

August 2010



JOHN CHIANG
California State Controller

August 18, 2010

John Mass, Chair
California Lottery Commission
600 North Tenth Street
Sacramento, California 95811

Dear Mr. Mass:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to public education for the quarter ended March 31, 2010.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$261,390,665, and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/sk

cc: John Menchaca, Commissioner
California Lottery Commission
Margaret Mims, Commissioner
California Lottery Commission
Joan M. Borucki, Director
California Lottery
Michael T. Ota, Deputy Director
Finance Division, California Lottery
Robert Zavala, Chief, Internal Audits
California Lottery

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Report of Analysis

Summary

In a letter dated May 26, 2010, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$261,390,665 to the Lottery Education Fund for disbursement to public education. Our review disclosed that the Lottery's accounting records supported this amount and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration. Our analytical review did not disclose any unexplained changes in accounts in a comparison with prior periods. Accordingly, on June 28, 2010, \$261,390,660.95 was transferred to the Lottery Education Fund.

The difference between the Lottery transfer request and the actual transfer amount is \$4.05. The difference is attributed to the complex calculations used to calculate funding and distribution for 7.9 million public California students. These calculations cannot allocate every cent accurately so, a small balance is left and carried over to the next quarter.

Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to public education. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine if the transfer of funds to public education was supported by amounts recorded in the Lottery's accounting records and to determine whether the Lottery is on target to comply with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

Background

In 1984, California voters passed an initiative, which, by amending the State Constitution, authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to public education, and established the allocation percentages for lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the California Lottery Commission and other special post-audits as the State Controller deems necessary.

Each quarter, the Lottery requests that the SCO transfer net revenues to public education (see Attachment). The Lottery request usually occurs eight to ten weeks after the close of the quarter.

Objectives, Scope, and Methodology

We perform this analysis of the quarterly transfer of funds to public education in order to determine whether:

- Transfer amounts are supported by the Lottery's accounting records; and
- The Lottery is on target to meet the annual allocation requirements specified in the Lottery Act.

We traced the transfer amount to Lottery financial statements and accounting records, and applied analytical review procedures to the lottery fund accounts by comparing them with those from the prior quarter and the prior year. We reviewed the actual costs for prizes and administration, as well as the quarterly fund transfer to public education to monitor progress in meeting the annual statutory requirements.

Results

After reviewing the Lottery's unaudited financial statements and supporting records for the quarter ended March 31, 2010, we determined that the Lottery's request to transfer \$261,390,665 to the Lottery Education Fund was supported by formal accounting records.

According to the Lottery's unaudited financial statements, the total amount available for transfer to education was \$823,218,810 for the nine month period ended March 31, 2010. Of this amount, \$289,843,672 (an additional \$4,420,315 withheld from the last quarter of the 2008-09 fiscal year pending annual financial statement audit and resolution of accounting issues, and \$7,297,200 for the 2008 audit adjustment) for the first quarter ended September 30, 2009, was transferred to the Lottery Education Fund on December 30, 2009, and \$271,984,473 was transferred to the Lottery Education Fund on March 30, 2009, for the second quarter ended December 31, 2009, leaving a balance of \$261,390,665 for the third quarter ended March 31, 2009. That was transferred to the Lottery Education Fund on June 28, 2010.

The amount transferred to public education was 34.54% of the total revenue for the quarter. The Lottery Act requires the Lottery to transfer at least 34% of the total annual revenue to the benefit of public education. All other income and unclaimed prizes were transferred to public education.

The Lottery complied with the statutory requirement that administrative expenses not exceed 16% of sales. Administrative expenses for the quarter were 12.20% of sales. To the extent that expenses are less than 16% of total annual revenues, the Lottery Act requires the surplus funds to be allocated to benefit public education. The surplus administrative funds were used to increase the prizes to the public. The Lottery returned 53.26% of the total quarterly revenues to the public in the form of prizes.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

August 18, 2010

Schedule 1— Summary of Lottery Transfers and Status of Compliance with Statutory Requirements

Fiscal Year 2009-10	Quarter Ended					
	09/30/2009	%	12/31/2009	%	03/31/2010	%
Sales ¹	\$ 797,978,266	100.00%	\$ 1,493,295,907	100.00%	\$ 2,242,907,213	100.00%
Prizes	\$ 427,670,458	53.59%	\$ 793,743,387	53.15%	\$ 1,194,510,180	53.26%
Administration	\$ 94,051,992	11.79%	\$ 180,429,092	12.09%	\$ 273,754,469	12.20%
Available for Education	\$ 276,255,816	34.62%	\$ 519,123,428	34.76%	\$ 774,642,564	34.54%
Other Income ²	13,587,856		42,704,717		48,576,246	
Adjustment	4,420,315 ⁶		—		—	
Adjustment	7,297,200 ³		—		—	
Transfer to Education	\$ 301,561,187		\$ 561,828,145		\$ 823,218,810	

Fiscal Year 2008-09	Quarter Ended					
	09/30/2008	%	12/31/2008	%	03/31/2009	%
Sales ¹	\$ 755,999,049	100.00%	\$ 1,464,063,575	100.00%	\$ 2,208,959,936	100.00%
Prizes	\$ 406,906,177	53.82%	\$ 783,073,238	53.49%	\$ 1,170,457,861	52.99%
Administration	\$ 97,556,880	12.91%	\$ 186,963,275	12.77%	\$ 282,915,271	12.81%
Available for Education	\$ 251,535,992	33.27%	\$ 494,027,062	33.74%	\$ 755,586,804	34.20%
Other Income ⁴	8,674,324		15,960,658		22,389,497	
Adjustment	3,609,618 ⁵		—		—	
Transfer to Education	\$ 263,819,934		\$ 509,987,720		\$ 777,976,301	

Annual Statutory Requirements

Prizes = Approximately 50% of sales

Administration = No more than 16% of sales

Available for education = At least 34% of sales

Other income = 100% due to education

Note: The actual percentage allocation is computed on an annual basis when determining whether the Lottery has met the allocation requirements. The percentages shown above indicate the Lottery's year-to-date progress toward meeting these requirements.

¹ Quarterly amounts represent fiscal year-to-date totals.

² Includes interest income, other income, and unclaimed prizes. The first quarter of FY 2009-10 includes proceeds from investments.

³ The amount represents the \$7,297,200 from the 2008-09 audit adjustment.

⁴ Includes interest income, other income, and unclaimed prizes. The fourth quarter of FY 2008-09 includes proceeds from investments.

⁵ This amount represents the \$3,609,618 withheld in the fourth quarter of FY 2007-08, pending the financial audit and resolution of accounting issues.

⁶ This amount represents the \$4,420,315 withheld in the fourth quarter of FY 2008-09, pending the financial audit and resolution of accounting issues.

**Attachment—
California Lottery's
Transfer Request of May 26, 2010**

600 North Tenth Street
Sacramento, CA 95811
calottery.com



May 26, 2010

Mr. Michael Havey, Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 500
Sacramento, CA 95816

Dear Mr. Havey:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$261,390,665. This figure represents:

Operating income for the nine months ended March 31, 2010	\$ 774,642,564
Proceeds from investments	32,640,407
SMIF interest earned	2,146,212
Other Income	158,098
Unclaimed prizes	<u>13,631,529</u>
	<u>\$ 823,218,810</u>
 Less: Transfer for the six months ended December 31, 2009	 \$ 561,828,145
	 <u>\$ 261,390,665</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the nine months ended March 31, 2010, prepared from books without audit, for your files.

Sincerely,

Michael Ota

Michael Ota, Deputy Director
Finance Division

Attachment

cc: Joan Borucki, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Nine Months Ending March 31, 2010

Lottery sales	\$2,242,907,213
Prizes	1,194,510,180

Sales after prizes	\$1,048,397,033

Less game costs:	
Retailer costs	\$159,252,615
On-line game costs	25,867,820
Off-line game costs	13,373,289

Total game costs	\$198,493,724

Income before operating expenses	\$849,903,309

Operating expenses:	
Salaries, wages and benefits	\$30,561,963
Advertising	14,767,997
Promotion, public relations and point of sale	6,531,885
Other professional services	7,305,187
Depreciation and amortization	7,709,849
Other general and administrative expenses	8,383,864

Total operating expenses	\$75,260,745

Operating income	\$774,642,564
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	(\$13,270,286)
Other Income	158,098
Allocation to Education Fund (Note 7)	(809,587,281)

Total non-operating (expenses) revenues	(\$822,699,469)
Changes in net assets	(\$48,056,905)
Total net assets-beginning of year	147,038,053

Total net assets-end of year	\$98,981,148
	=====

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>